SEPTEMBER 2011

September revealed a change in tone from the Administration as the President traveled the country to support his jobs legislation, challenging Congress to vote up or down on his legislation. Meanwhile, the Joint Select Committee on Deficit Reduction – also known as the 'Super Committee' – got down to work considering proposals that range from additional job stimulus to tax reform to major cuts in entitlement. The institutional investor community was disappointed by the SEC's decision not to fight for their proxy access rule. Finally, the Administration continued to aggressively move forward with the implementation of the Affordable Care Act even as the Justice Department moved to expedite a Supreme Court review of its constitutionality.

ISSUES AND EVENTS

Supreme Challenge: Obama Administration Asks Supreme Court to Hear Healthcare Law Case

The Justice Department has asked the U.S. Supreme Court to review a ruling from the U.S. Court of Appeals 11th Circuit in Atlanta in an apparent effort to force an endgame on the law before the Presidential election in 2012. The appeals court found one portion of the law unconstitutional, although that court let the remainder of the law stand. At issue is the mandate to purchase health insurance or pay a penalty, a key provision to the Patient Protection and Affordable Care Act that requires nearly all Americans to purchase health insurance. That provision has been under fire from the time the legislation was signed into law in 2010.

The decision by the Obama administration's DOJ capped three days of speculation about what the White House would do. The administration let slip its last chance to ask the full appeals court in Atlanta to review its previous decision, a move that might have allowed the Atlanta court to overturn its prior decision and thus strengthen the law's chances of being upheld when it finally is heard by the Supreme Court. The alternative for the White House was to wait until the high court heard the case – possibly not until 2013 – robbing the President of the opportunity to champion his signature health care bill in advance of his re-election bid. Some felt that President Obama was compelled to add urgency to the court's decision out of fear that if not re-elected, a Republican president would not vigorously defend the law.

The plaintiffs in a 26-state challenge to the law filed a formal appeal for the Supreme Court to take up the issue in its next session. On the same day, the Obama administration played its hand, asking the Supreme Court to review the 11th Circuit Court of Appeals' decision.

"The Department has consistently and successfully defended this law in several court of appeals, and only the 11th Circuit Court of Appeals has ruled it unconstitutional," the Justice Department said in a written statement. "We believe the question is appropriate for review by the Supreme Court."

The law continues to trigger challenges and test precedents as various courts around the country take up related issues. Three appeals court judges in Washington D.C. questioned whether the ACA constitutes a new direction is social policy and whether the courts should "get in the middle" of that movement. As one Republican judicial appointee said, "This could be the blueprint for a privatized social safety net."

Lower courts have issued conflicting rulings on the health care law. On June 29, the 6th Circuit Court of Appeals in Cincinnati upheld the law in a 2-1 ruling in a case brought by the Thomas More Law Center of Ann Arbor, Michigan. In early September, the 4th U.S. Circuit Court of Appeals in Richmond threw out two lawsuits challenging the constitutionality of the law. The cases were decided on issues of standing and jurisdiction, with the court declining to rule on the merits of the law.

President Proposes Cuts in Health Care Programs

As part of his deficit reduction plan, the President proposed cuts to Medicare and Medicaid, entitlements that comprise nearly one fifth of federal government spending. His proposals were received with skepticism by members of Congress and objections by consumer groups who feared the plan would shift too much Medicare and Medicaid costs to the states.

Democrats in Congress objected to deep cuts in health benefits that millions of Americans rely on, while Republicans claimed the proposed changes are too small to make a significant difference and pointed out the proposal will keep Medicare solvent for just three more years. A health policy analyst for the Republican Policy Committee claimed the cuts would save only three percent of combined federal spending on the program.

President Obama's plan identified $248 billion in savings from Medicare over the next 10 years, while he targeted $73 billion from Medicaid. The biggest change would be a provision that requires drug manufacturers to give low income Medicare enrollees the same price breaks provided to Medicaid recipients. The change would save $135 billion over 10 years. Other parts of the plan would:

- increase premiums on Medicare B and D programs for upper income beneficiaries;

- add a new co-payment for home health care services,
- increase Part B deductibles,
- and place a surcharge on some Medigap insurance policies.
- The administration also would limit the amount of taxes states can impose on providers in order to increase their matching funds.

The plan did not contain a recommendation to raise Medicare eligibility from age 65 to 67, for which Democrats offered praise.

SEC Disappoints Investors with Decision to Abandon Proxy-Access

Investors seeking a regulatory right to place board candidates on corporate proxy cards were disappointed when the US Securities and Exchange Commission announced it would not appeal a decision by a DC appeals court that struck down the SEC's so-called proxy access rule.

Following the enactment of the Dodd-Frank Consumer Protection and Wall Street Reform Act, which clarified the SEC's authority to issue proxy access rules, the SEC finalized a proposal that would allow shareowners who have held at least three percent of a company's stock for three years to place one candidate on the company's proxy card. As anticipated by many observers, the business lobby- led by the Business Roundtable and US Chamber of Commerce immediately challenged the proxy access rule, arguing that the SEC had not sufficiently assessed the costs and benefits of the rule.

The US Court of Appeals for the DC Circuit agreed.

In a sweeping decision, a three-judge panel of the DC Circuit weighed the evidence relating to the cost of implementing this rule from a study by the SEC against a competing study by the business community. Extending no deference to the SEC, the court essentially ruled that it believed a comment letter raised by the Chamber – who have long opposed providing shareowners meaningful proxy access- was not sufficiently considered during the rulemaking process. Although the precedent established by this case could impact litigation on future rulemaking, the SEC is rumored to believe proxy access is too "toxic" an issue for the agency to seek review. Instead, according to industry experts, the SEC will likely look for a different vehicle to try and overturn this anti-regulatory decision.

Institutional investors, including CalPERS, who fought hard to ensure proxy access language was included in Dodd-Frank and who have a long history of supporting SEC regulations, were deeply saddened by the SEC's decision to abandon the groups' top regulatory priority. According to SEC insiders, the decision not to appeal the case stemmed from a lack of vocal support for the SEC and silence by institutional investors over any outrage by the appellate court's decision.

Industry experts have been told that a new proxy-access rule will likely take 3-4 years to finalize because of the questions raised by the DC Circuit and other rulemaking priorities.

Nevertheless, a group of public pension plans – including CalPERS – continue to discuss ways to encourage the SEC to immediately re-start rulemaking on proxy access.

Senior Lawmakers Say No Increased Funding for SEC Without Major Overhaul

The Securities and Exchange Commission should not receive an increase in its funding until the agency is restructured, the chairman of the committee which oversees the regulator declared at a recent hearing. House Financial Services Committee Chairman Spencer Bachus (R-AL) opened a hearing on SEC oversight by declaring that the agency, empowered with new sweeping authority by the Dodd-Frank Act, should not receive a bump in its appropriation unless it is reorganized. Bachus said the SEC could reform itself or have Congress restructure the group.

"A lot of Republicans and Democrats and others have said that before the SEC obtains additional funding, there need to be reforms," Bachus told the committee. "My personal view is that an increase in funding is probably necessary as part of the reform process."

Democrats expressed concern about delaying increases to the SEC's budget, given the new responsibilities to regulate swaps, municipal advisors and other market participants. Rep. David Scott (D-GA) emphasized that the SEC's budget has no impact on overall federal spending because it's funding is derived from user fees collected from market participants.

SEC Chairman Mary Shapiro explained that the SEC collected more than $2.2 billion in fines and penalties in 2010, more than double the agency's budget last year. Shapiro also touted a number of internal reforms the agency has overtaken in recent months, including the consolidation of the Office of the Chief Operating Officer and the creation of a Chief Compliance Officer.

One lawmaker cautioned that additional funds should not be used to layer additional regulations into the agency and that Congress should not reward inefficiency with additional money. But Ranking Member Barney Frank (D-MA) deflected talk about rewarding inefficiency with more money saying, "Don't penalize the American public further because agencies that were supposed to be protecting them didn't do the job well enough." He referred to an audit report that said a major problem facing the SEC is a significant increase in responsibility, but with inadequate resources to do the job.

While the House was conducting its hearings on the financial regulatory agencies, the Senate Appropriations Committee backed legislation that would boost funding for both the SEC and the Commodity Futures Trading Commission (CFCT). The Financial Services and General Government Subcommittee gave voice approval to a draft spending bill calling for $1.4 billion for the SEC and $240 million for the CFTC, both significant increases over 2011 funding. The subcommittee chairman, Senator Richard Durbin (D-IL), said the two agencies needed additional funds to upgrade "sophisticated electronic tools to analyze and collect market data in real time."

SEC Cost-Benefit Bill Touted by Subcommittee Chairman

The chairman of the House subcommittee responsible for supervising the SEC wants the agency to conduct a cost-benefit analysis for every order issued by the securities regulator.

The SEC Regulatory Accountability Act, introduced by Securities Subcommittee Chairman Scott Garrett (R-NJ) would require the agency to consider the cost and benefits of every regulations and order, including enforcement orders and exemption orders that frequently allow products to go to market more quickly. Garrett said the legislation is designed to strengthen the SEC's cost benefit analysis.

"To me, these common-sense reforms make a lot of sense, especially given the fact that the Commission continues to struggle with this issue," Garrett said. "For instance, in the recent unanimous opinion of the DC Circuit Court of Appeals, which vacated the Commission's proxy access rule, the Court stated that 'the Commission acted arbitrarily and capriciously for having failed once again to adequately assess the economic effects of a new rule' and 'inconsistently and opportunistically framed costs and benefits of the rule.'"

Rep. Jim Himes (D-CT) took issue with the Garrett bill and suggested a different way of thinking about the costs and benefits for financial regulations. "The financial industry is different [than other areas of regulation]. We are talking about truly catastrophic events if we get it wrong," he charged. "I'm not sure you can analyze the cost associated with the incredible destruction of American wealth, the millions of people out of work… and we should do almost anything to avoid [that]."

Others took issue with the sweeping nature of the bill and its impact on the SEC's enforcement program. "The notion that before you could bring an enforcement order, you'd have to do a cost-benefit analysis seems to me really quite odd," Rep. Barney Frank (D-MA), ranking member of the House Financial Services Committee, told SEC Chairman Mary Shapiro.

"I believe this would be very damaging to the enforcement program," Shapiro replied.

Rep. Maxine Waters (D-CA) opposed the Garrett bill saying that it was unnecessary. She noted that the bar for compliance with the currently cost-benefit requirements are already very high, citing the DC Circuit's proxy access decision.

HHS Announces New Initiatives – Distributes ACA Funding

Throughout the month of September, the Department of Health and Human Services continued the distribution of funds authorized by the Affordable Care Act.

The Health Resources and Services Administration (HRSA) announced $8.5 million to help fund 85 health centers in 15 Beacon Communities across the country. Beacon Communities receive funds to build and strengthen their HIT infrastructure and exchange capabilities to improve care coordination, increase the quality of care, and slow the growth of health care spending. San Diego is designated as a Beacon Community, and California will receive a total of $1.3 million for 13 community health centers.

"Beacon Communities are about empowering doctors, nurses, patients, and community leaders to come together and use technology to make tangible differences in the lives of everyday Americans," said HRSA Administrator Mary Wakefield, Ph.D., R.N.

Recognizing that "For many Americans, community health centers are the major sources of care that ranges from prevention to treatment," HHS Secretary Kathleen Sebelius announced another $700 million of grant money to be sent to the states to bolster community health services through building new health centers and hiring healthcare workers. This initiative will be targeted to medically underserved areas. California has 1,781 such designated areas and will be a recipient of funds. HHS also announced an additional $ 11.9 million for rural area health clinics and new hiring.

California will also receive an additional $2,237,260 in new health care funds from the Affordable Care Act. The grants were issued through HHS and the Centers for Disease Control.

The Secretary identified state, tribal, territorial and local health departments as recipients of the new funds designated to serve local health clinics and hire healthcare professionals. This is the second year of the CDC's 5-year program known as the National Public Health Improvement Initiative (NPHII), designed to bolster public health infrastructure as a means of keeping health care costs down through direct disbursement of funds and local treatment.

In related news, the Centers for Medicare & Medicaid Services reported that more seniors and people with disabilities on Medicare are seeing reduced costs for important health care -- through both discounts on brand-name drugs in the Medicare Part D "donut hole" coverage gap and free preventive care. Nearly 1.3 million people with Medicare are receiving discounts on prescription drugs, a 50 percent discount on brand-name prescription drugs worth $660 million savings so far this year. The CMS reported that individuals receiving the drug discount have saved an average of $517 each. There are 18.9 million seniors receiving preventive care at no cost to them.

Senate Finance Committee Weighs Tax Reform Issues for Pension Plans

During a hearing in which pension experts presented testimony about the need for tax reform and incentives to create more sustainable retirement benefits for American workers, Senate Finance Committee Chairman Max Baucus (D-MT) said the shift toward defined contribution plans "blurs the line between personal savings and retirement benefits." He expressed concern defined contribution plans, like 401(k) accounts, would not adequately support retirees because they are managed by individuals who are not required to contribute and who can spend the money in lump sum, or even before retirement.

Baucus reported the majority of American workers no longer have defined benefit pensions, and with the median annual Social Security income of only $14,000, too many retired workers will not be able to cover even their most basic needs in retirement. Baucus cited a GAO report that the median retirement account for Americans aged 60-64 was just $60,000 and calculated that retirees could afford to spend just $4,200 per year on top of their Social Security income. Approximately 84 percent of American workers had defined benefit pension plans in 1980, but that fewer than half had guaranteed pension plans by 2007 – with the trend continuing away from defined benefit retirement security.

Ranking Member Orrin Hatch (R-UT) defended 401(k) and IRA retirement savings, claiming that, "the greatest wealth in the history of the country" has been amassed because of 401(k) accounts and IRAs, and that "more money has been set aside for retirement in defined contribution plans and IRAs than in Social Security." Hatch said there is currently $2.6 trillion in Social Security and there is $ 4.7 trillion in private 401(k) plans, with another $ 4.9 trillion in IRA accounts.

A panel of pension and employee retirement benefits experts discussed proposed changes in the tax code to strengthen retirement savings. Panelists supporting tax reforms to create better incentives for workers and employers to build wealth using 401(k) and IRA savings plans squared off against pension plan supporters who claimed the large numbers of dollars saved in the last 30 years in 401(k) plans belongs disproportionately to higher income earners because of current tax code rules.

"We can celebrate the very large sums of money that are in 401(k)s and IRAs right now, but it's worth noting the personal savings rate has gone down markedly in the 30 years since we've moved away from the traditional system," testified a senior fellow at Brookings Institute. He said only about half of American workers have access to an employer sponsored retirement system and the median balance in American 401(k) accounts is less than $10,000. He also noted that taxpayers in the 35 percent tax bracket get a 35-cent tax break on every dollar contributed, while lower income workers in the 10 or 20 percent brackets who need more savings get just a 10 or 20-cent tax break for every dollar earned.

Panelists were split about whether there should be a cap on the amount of money employees can deposit into a 401(k) retirement account or IRA, and whether caps and other restrictions on employer contributions that might limit their tax advantage would create a disincentive for them to sponsor retirement plans for their employees. If so, the trend for employers to abandon workplace retirement plans would only exacerbate the current problem of having so few private sector workers with access to employment that provides any retirement program. Workers in lower income brackets are the least likely to have access to retirement plans, despite needing them the most. Both sides agreed that creating stronger incentives for workers to save money will be critical.

Karen Friedman, executive vice president and policy director of the Pension Rights Center (who spoke at the CalPERS Board offsite in January), outlined some short-term measures that should be considered to increase retirement savings, particularly among lower- and moderate-income workers:

- Expanding the Saver's Credit and making it refundable.
- Instituting reverse matches for 401(k) plans and Simplified Employee Pensions.
- Encouraging new forms of traditional defined benefit pension plans.

"Tax incentives are meant to encourage employers to set up plans and to encourage employees to save for retirement. However, they end up disproportionately benefitting the most affluent employees, who do not need tax incentives to save," she said, adding, "We need to dream big to get where we need to be. While the economy is in turmoil, we must be even more creative in deploying our tax system to meet the challenges of today's and tomorrow's retirees."

Census Data Sparks Conflicting Claims on Success of Affordable Health Care Act

The number of Americans without health insurance grew to 49.9 million last year, up 900,000 in 2010 over 2009 according to a Census Bureau report released on Monday, although there were significant gains in enrollment for young adults. The released data sparked a flurry of conflicting claims among Republicans and Democrats about whether gains in insurance coverage for the young will offset increased need for government provided health insurance by those who have lost jobs.

Senate Finance Committee Chairman, Max Baucus (D-MT) issued a response to the Census report commending the Affordable Care Act, citing the fact that insurance enrollment among young adults aged 18-24 jumped by more than 500,000 from 2009 to 2010. "Millions of young people are able to remain covered by their parents' insurance today thanks to the Affordable Care Act. Today's report proves the progress covering young adults on their parents' insurance plans and shows that health reform is working. As additional provisions kick in over the coming years, even more Americans will be covered by quality, affordable plans."

But the new data also seemed to confirm a shift away from employer-sponsored health insurance, to government provided insurance. Critics of the Obama administration attributed that shift to the faltering economy and loss of jobs. The report showed that even before the economic downturn, the number of people enrolled in employee sponsored health insurance plans was declining. The Republican Policy Committee claimed the report was further evidence that the President's stimulus package to jump-start the economy was a failure. "To the extent the increase in the number of uninsured reflects a drop in employer-sponsored coverage, this number reflects the continued lack of economic growth — and, more critically, jobs growth — under this administration's policies," said a Republican Policy Committee analyst.

House Ways and Means Health Subcommittee Ranking Member Peter Stark (D-CA) praised the Patient Protection and Affordable Care Act for the good news. "Prior to health reform, young adults had the lowest rate of insurance coverage, putting them and their families at risk of financial ruin should an accident or unexpected illness occurs. Today's data show that thanks to health reform, one million young Americans can now put this worry to rest. In our sluggish economy when a job -- much less one with health benefits -- is difficult to come by, that's especially meaningful peace of mind."

RELATED NATIONAL AND INDUSTRY NEWS

Municipal Groups Send 'Super Committee' A Message: Leave Our Tax Exempt Status Alone!

Twenty-two state and local municipal groups sent a letter to the Deficit Reduction Super Committee in advance of their first meeting last week to emphasize their objection to any proposed changes to their tax exempt financing for municipal bonds.

"In a world in which there are likely reductions to domestic discretionary and perhaps even mandatory and entitlement spending, it is critical that this tool be preserved in order for us to protect our investments," said Michael Bird, federal affairs counsel for the National Council of State Legislatures.

"NCSL truly understands that if you are going to do serious deficit reduction and debt-management control, we are going to have to make a contribution to that reduction, and since federal funding will therefore diminish potentially in the future, the retention of tax-exempt financing becomes all that more important," Bird said.

Municipal and state governments have been aware for some time that tax exempt municipal bond status would be on the table in any discussion of entitlement reform. Sens. Ron Wyden (D-OR) and Dan Coats (R-IN), introduced tax-reform legislation in April that would categorize all new municipal bonds as tax-credits, instead of tax-exempt. President Obama's National Commission on Fiscal Responsibility and Reform issued a report last November that proposed denying tax-exempt status for municipalities, and a recent Standish Mellon Asset Management Growth, Co. report cited research that showed tax-exemption ranks ninth among the top 10 federal tax expenditures with a cost of about $200 billion from 2010 through 2014.

GAO Warns Defined Benefit Pension Plans About Hedge Fund and Private Equity Investments

The Government Accounting Office on Wednesday released a report warning that defined benefit pension plans (public and private) face significant challenges when investing in hedge funds and private equities. The report referred to recent turmoil in the markets and said, "[it] is important that plan fiduciaries apply best practices, and choose wisely when investing plans' assets to ensure that plans are adequately funded to meet future promised benefits."

The report revealed that "A growing number of private and public sector pension plans have invested in hedge funds and private equity, but such investments generally constitute a small share of total plan assets. According to a survey of large plans, the share of plans with investments in hedge funds grew from 11 percent in 2001 to 60 percent in 2010. Over the same time period, investments in private equity were more prevalent but grew more slowly--an increase from 71 percent of large plans in 2001 to 92 percent in 2010. Still, the average allocation of plan assets to hedge funds was a little over 5 percent, and the average allocation to private equity was a little over 9 percent." The report indicated that larger public pension plans are more likely to invest in hedge funds and private equities.

The GAO said that hedge funds and private equity investments can offer higher profits, but equally significant losses, particularly since they often are illiquid. The GAO also said the Department of Labor had agreed to formulate guidance regulations for these investments, but has not yet done so, and that the lack of uniformity in these investment vehicles could likely complicate that process.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

Short-term Highway Reauthorization Bill Approved

California Senator Barbara Boxer, Democratic Chairwoman of the Environment and Public Works Committee won approval on Thursday for a four-month extension of the federal highway surface transportation bill in the Senate, though long-term reauthorization is still being negotiated. She is working with Senate Finance Chairman Max Baucus (D-Mont.) to identify off-sets in spending to finance it. Transportation spending is a key measure of the President's jobs plan, and one of the few common points of agreement for spending between Republicans and Democrats in measures to improve infrastructure while putting Americans back to work.

House Leaders Applaud DOL for Reviewing Definition of "Fiduciary" – Retirement Security Called a Key Issue

John Kline (R-MN), Chairman of the House Education and Workforce Committee, joined Health, Employment, Labor, and Pensions Subcommittee Chairman Phil Roe (R-TN) in praising the Department of Labor's decision to review its rule on the definition of "fiduciary" as part of banking reforms, claiming that an overly restrictive definition would intimidate businesses from offering pension plans to employees. But Democratic leaders urged the DOL to continue working to create a rule that will protect individual investors, especially those depending upon employer assistance for a retirement plan. Senator Tom Harkin (D-IA), chairman of the Senate Health Education and Labor Committee and Rep. George Miller (D-CA), Ranking Member of the House Education and Workforce Committee, urged the Department to "move forward without delay on a reproposal that will provide significantly increased protections for Americans concerned over their retirement security while being both practical and easy to manage."

California Congressman Miller urged the DOL to keep trying to find a balance that will provide the protection he says individuals need. He is the author of legislation that would reveal hidden fees in 401(k) accounts, and has long been a voice for secure retirement and pension plans. Miller's statement said in part, "Today, the Department of Labor announced it would be taking further steps to make sure that it comes up with the best possible rule – a rule protecting the millions of people that rely on advisers when they make decisions about their retirement accounts. The retirement system is complex, and there are a lot of issues to consider. But the simple fact is that bad investment advice threatens the retirement security of middle class Americans."

Issa Advances Efforts to Repeal Regulations; Waxman Challenges Agenda

California Rep. Darrell Issa, Chairman of the House Oversight Government & Government Reform Committee, announced three hearings on deregulation suggested that President Obama could find common ground with Republicans on reform issues. "One area where Congress and the President can work together to create jobs and grow the economy is in the area of regulatory reform and uncertainty," Chairman Issa said. He pointed to 75 new major regulations that he said will cost American businesses about $38 billion each year in compliance. He also said the government would have to hire more than 10,000 regulators in the next year, while job losses in the private sector are at unacceptably high levels. Issa said the regulatory climate was "putting a brake on entrepreneurs and hurting job creation."

Other influential GOP committee members also vocalized their intention to focus on regulatory repeal as a means to stimulate business and create jobs. Energy & Commerce Committee Chairman Fred Upton (R-MI) issued a press release to say that Committee is working across the board on "legislative solutions to protect families and jobs from the economically devastating regulations imposed, proposed and contemplated by the Obama Administration – regulations that will cost billions of dollars and tens of thousands of jobs to implement."

But Henry A. Waxman of California, the top Democrat on the Energy and Commerce Committee, said efforts to overturn federal rules are an "open assault" on government. "[Republicans] don't believe in government functioning, even if it's to protect people from getting cancer, birth defects or neurological diseases from toxic substances," he said. Minority Leader Nancy Pelosi (D-CA.) asked about the purpose of such strong focus on regulation repeals, saying, "The president has his own review, has made significant recommendations about reducing regulations where they are duplicative, obsolete, or just really are not fulfilling their purpose."